

**Julia L. Johnson**  
Chairman

State of Florida



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## Public Service Commission

April 22, 1997

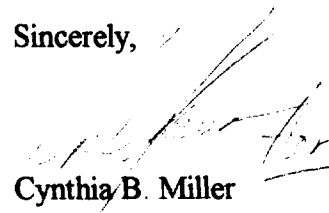
Mr. William Caton  
Secretary  
Federal Communications Commission  
1919 M Street NW, Room 222  
Washington, DC 20554

Re: CC Docket 96-45 - Universal Service; and CC Docket 96-98/- Implementation of  
the Local Competition Provisions - EX PARTE FILING

Dear Mr. Caton:

Pursuant to Rule 1.1206, an original and one copy of the filing are enclosed. Chairman Julia L. Johnson and staff are meeting with the Chairman and the other Commissioners and their aides Tuesday, April 22, 1997, to discuss and to disseminate a letter to Chairman Reed Hundt regarding the use of the same cost studies for universal service and unbundled network elements. The staff attending the meeting are Bridget Duff, Walter D'Haeseleer, Mark Long, David Dowds, and Dale Mailhot.

Sincerely,

  
Cynthia B. Miller  
Senior Attorney

CBM:ml

Enclosure

cc: Chairman Reed Hundt

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## Public Service Commission

April 22, 1997

The Honorable Reed Hundt  
Chairman  
Federal Communications Commission  
1919 M Street NW  
Washington, DC 20554

Re: Your request for more information regarding using the same cost studies for universal service and unbundled network elements

Dear Chairman Hundt:

At a meeting in your office on March 27, and on a conference call with me and other NARUC members, you expressed concern that the proxy models were not sufficiently developed for immediate adoption and implementation. We all expressed some concern that the current models were not adequate, and agreed that there was a need to develop a process whereby the models could be further tested and developed. We also discussed the need and the desire for federal and state regulators to continue working together to develop costing models that produce accurate and sustainable results.

You have asked States to provide you with comments on how and whether state forward-looking cost studies for unbundled network elements (UNEs) could be used to help determine the cost of universal service or, at a minimum, whether such cost studies could serve as a "sanity check" on the proxy models' outputs. My staff informed you that because the goals of determining costs for UNEs and universal service are different, the cost models to be applied should also be different. You asked that we provide you with further information on why we employ two distinct cost standards for unbundled network elements and universal service.

The basic reason for using different principles is related to the assumption that cost studies for universal service contemplate network architectures, technologies, and input prices different from those associated with the current ILEC networks which are to be unbundled for UNE purposes. It is reasonable to fund high cost support based on a theoretical "efficient design" network principle that assumes the ability to instantaneously build an optimal, cost-efficient network that satisfies all existing demand at that point in time. This is because the Act contemplates there will be competition on a going-forward basis from multiple providers using different types of networks, and that universal service support mechanisms should be explicit and

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competitively neutral. If the funding for universal service were based on, for example, the costs associated with the incumbent LECs' (ILECs) networks, alternative local providers whose costs were lower could receive excessive compensation. To be competitively neutral thus requires that a universal service mechanism be provider-neutral. Therefore, it makes sense that a purely hypothetical network should be used to approximate costs for a permanent high cost funding mechanism.

For purposes of interconnection and UNEs, however, the goal in determining costs is much different than the goal in determining costs for purposes of designing and sizing a permanent high cost funding mechanism. In the case of interconnection and UNEs, the goal is to determine the costs of pieces and parts of an actual existing network. UNEs such as unbundled loops will be provided by a LEC using an in-place network, not some hypothetically constructed network. However, while the appropriate cost analysis reflects the LEC's actual loop characteristics (such as length, quantity, geographic location, etc.), forward-looking technology is modeled and current input prices are used. If a purely hypothetical network were the basis of cost studies used for setting prices for interconnection and UNEs, the resulting costs likely would be lower than if cost studies were based on the existing network. Consequently, there would likely be little incentive for new entrants to build their own networks, since a "scorched" network design assumption would result in prices for using the incumbents' networks that were equal to or less than the costs of building a new network. Beyond the incentive to use the least cost option, firms strive to minimize their exposure to risk. Building facilities inherently carries investment risk and delays market entry. These factors make it all the more important to send the proper pricing signals to potential entrants. Finally, if a hypothetical network were the basis for UNE cost studies, it is more likely that the incumbent LECs would claim an illegal taking of property on the basis that they are not being adequately compensated for the true costs of their networks.

You have correctly stated on numerous occasions that 33 out of 35 states have adopted forward-looking cost methodologies for UNEs. While Florida is one of the 33 states that has adopted a forward-looking cost approach for UNEs, we have not adopted a "scorched earth" or "scorched node" approach. The critical difference between the FCC's "scorched node" forward-looking cost analysis and the type of forward-looking cost analyses endorsed by Florida (and by other states), is that our UNE cost studies are based on existing, real world networks and optimum future deployment based on these networks. These studies determine the LEC's long run incremental cost of providing an element, while acknowledging that the selection of least-cost technology is pragmatically constrained based on the economics of adding to an array of telecommunications equipment already in the network today. In contrast, the FCC adopted a "LEC in the box" approach for determining the costs for UNEs in its August 8, 1996 interconnection order. The FCC's analysis assumes nothing, or nothing except for the locations of switches, is in place and the entire network is constructed from scratch, based on the most

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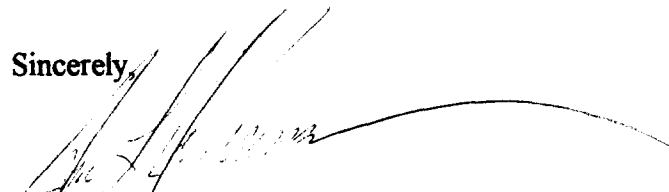
cost-effective and efficient choice of technologies. Under this approach, a state of the art network sufficient to meet all current demand is instantaneously built. I believe that this costing methodology is inappropriate for pricing UNEs, because the methodology does not reflect any provider's current or prospective cost structure.

By employing cost studies that are based on existing real world networks and optimum future deployment of these networks, Florida's approach to UNE costing achieves a reasonable balance between the actual and hypothetical deployment of facilities. These analyses incorporate a firm's prospective technology practices at their current and prospective prices, and thus exclude obsolete and inefficient technologies and network design practices. Since the methodology yields incremental costs that are representative of a LEC's actual network characteristics, but based on efficient designs, network element prices set using these costs will be compensatory and sustainable: compensatory because they cover the firm's costs, and sustainable because they reflect current and prospective least-cost engineering practices.

We both agree that the existing universal service cost proxy models still require significant work before any reliance should be placed on their results. Development efforts should continue on these models, while also researching other possible options. Conceivably, the results from state-approved UNE cost studies might be useful as sanity checks for the proxy models; however, I would urge extreme caution. It is doubtful that the states have all conducted their cost studies for UNEs using the same methodology, so it is unknown to what extent the various cost studies can be reasonably compared to one another. Prior to comparing UNE cost study results to those from a proxy model, it is crucial to understand the key underlying assumptions and modeling techniques of each of the studies to be compared. Absent this information, an "apples and oranges" comparison could result. However, if due care is exercised, there may be merit in performing comparisons between proxy model results and those of UNE cost studies.

I look forward to working jointly with the FCC and states through the Universal Service Joint Board process on this effort.

Sincerely,



Julia L. Johnson  
Chairman  
Florida Public Service Commission